TESTIMONY OF

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"PROFESSIONAL SERVICES: PROPOSED CHANGES TO THE SMALL BUSINESS SIZE STANDARDS"

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INTRODUCTION

Chairman Walsh, Ranking Member Schrader, and members of the Subcommittee, thank you for the invitation to testify and the opportunity to discuss small business size standards.

My name is Roger Jordan and I am the vice president of government relations at the Professional Services Council. PSC is the national trade association of the government professional and technical services industry. PSC's nearly 350 member companies represent small, medium, and large businesses that provide federal agencies with services of all kinds, including information technology, engineering, logistics, facilities management, operations and maintenance, consulting, international development, scientific, social, environmental services, and more. Roughly 20 percent of our members are small businesses and another approximately 30 percent would be considered small mid-tier firms. Together, the association's members employ hundreds of thousands of Americans in all 50 states.

When debates about industry size standards applicable to federal procurements occur there is often very little agreement. Company executives' opinions typically fall into one of three buckets depending on the current size of their company. For example, very small companies tend to advocate for lower size standards; companies operating in the middle of their industry size standard's range tend to advocate for the status quo; and companies that are approaching or slightly above their size standard seek a higher level. The reason for the varied opinions is simple: companies have a keen interest in maximizing their ability to compete for and win federal contracts that are exclusively set aside for small business competition. As such, there is much to be gained competitively from qualifying as a small business. This is especially true since the current approach to determining companies' size status results in companies being placed into one of two categories—either you are a small business or an "other-than-small" business left to compete with companies that are clearly dominant in an industry. This binary approach means that once companies exceed their industry size standard, even if only by one dollar, they are left on their own to compete in the full and open marketplace. Some succeed, others do not.

Reaching a consensus among these varying opinions is virtually impossible. However, one area in which most agree is that, after nearly 30 years without a comprehensive revision to industry size standards, it is time for the Small Business Administration to reevaluate them. This is an unenviable task that SBA has appropriately undertaken and their challenge is significant for a number of reasons. To properly adjust size standards, SBA must collect and digest significant amounts of data about the commercial and federal marketplaces, and often relevant data simply doesn't exist. In addition, SBA must have an in depth understanding of the federal contracting market and how the dynamics of that market are changing, either through natural evolution or because of the implementation of government policies.

BACKGROUND

On March 16, 2011, SBA published its much-anticipated proposed rule updating the small business size standards for 36 industries operating in the Professional, Scientific and Technical categories—often referred to as the "54" category because of the corresponding number assigned to them under the North American Industry Classification System (NAICS). The March 16 proposed rule is the third rule to be published within the last year proposing changes to broad industry categories. SBA will continue to revise other categories on a rolling basis. Examples of industries that fall under category "54" include legal services, tax preparation services, architectural and engineering services, many computer related and information technology services, and a number of consulting services, including management consulting, logistics consulting, scientific and technical consulting. In total, the federal government spends approximately $132 billion on contracts in these categories, while small business participation exceeds $30 billion (approximately 23 percent) at the prime contract level and is estimated to be considerably higher at the subcontract level.

SBA began its process of revising the size standards by developing a methodology based on five significant factors: average firm size; startup costs and entry barriers; industry competition; distribution of firms by size; and impact on federal contracting and SBA loan programs. SBA will also consider other factors such as technological changes and industry growth changes.

The thresholds established for determining small business size status are important for a number of reasons. First, SBA uses the size standards to determine whether a business is eligible to apply for, and receive, loans through the various SBA-backed loan programs. Similarly, small firm status must also be verified for businesses seeking assistance from SBA in order to recover from catastrophic natural disasters or terrorist attacks. Second, size standards are important to determine businesses' eligibility to compete for, and be awarded, federal contracting opportunities set-aside exclusively for small business competition. Third, the size standards are used by prime contractors to determine small business eligibility for their subcontracting plans required by the federal government to ensure that small businesses have ample opportunity to participate at the subcontracting, as well as prime contracting, levels.

SBA's analysis and update of these size standards is necessary because, other than periodic inflationary adjustments, it has been several decades since the size standards have been substantially reviewed and updated. During this timeframe, industries—especially the professional services industry—have changed significantly and the dynamics of the federal professional services marketplace are also much different than they were 15 years ago. Most significant is the general growth in the amount the federal government spends on professional services annually. Fifteen years ago the estimated amount that the federal government spent on ALL services was $114 billion. Today that figure is upwards of $335 billion. This increase means that there are considerably more opportunities for professional services providers to partner with the federal government. It also means that significant opportunities are being set-aside for exclusive small business competition in the fields of professional, scientific, and technical services. The growth in the marketplace and increases in small business opportunities have been factors in increased calls for revisions to the size standards to ensure that accurate figures are dictating which companies are eligible for set-aside competitions. However, these are not the only factors that are fueling debate. A number of changes in the federal contracting market are also significant contributors.

CONSENSUS DIFFICULT, IF NOT IMPOSSIBLE

First, I would like to commend SBA's Office of Size Standards for its efforts on its size standards initiative, as updating them is a significant challenge that requires critical economic data analysis as well as a thorough understanding of the federal marketplace and key policies that impact it. Furthermore, SBA is unlikely to satisfy all interested parties because, as stated above, individual companies are likely to adopt a position on the issue based on their current situation.

Nonetheless, there are other critical questions that need to be addressed early in the process. At present, it is not at all clear that these questions were fully considered. Key among these questions is a definition of the PURPOSE of the government's small business program. Is the intent of small business contracting initiatives to help CREATE small businesses and then protect those that wish to maintain their small business status, or are these initiatives intended to serve as an incubator to foster the development, growth, and sustainability of companies? This is a critical question, particularly in the federal procurement marketplace; and the answers may well differ depending on one's perspective.

At PSC, we and our members have adopted the philosophy that the intent of the small business program is to foster growth to help facilitate long-term success of companies with the entrepreneurial spirit, and we believe this philosophy is shared by the current leadership within SBA. This position supports the need for size standards in the higher range. This does not mean that the standards should be set so high that they act as significant barriers to smaller companies seeking to break into the federal market. Rather, SBA must seek to balance size standards so that small businesses have legitimate opportunities to compete, yet higher revenue generating small firms that are not dominant in their field are not shut-out from competing for small business set-asides.

REALITIES OF THE FEDERAL MARKETPLACE

As I mentioned earlier, the characteristics of the federal marketplace have undergone significant changes in the last 15 years, and these changes have created "realities" that simply cannot be ignored when discussing industry size standards.

First, the government market for professional services has become increasingly dominated by indefinite delivery/indefinite quantity multiple award contracts which, in turn, have resulted in a marketplace where a significant amount of professional services are now procured at the task order level. In the past, the majority of such work was procured through individual contracts. This shift to task order purchases has had enormous impacts on the marketplace. The costs to compete have risen significantly, as companies of all sizes, have to bid to win a position on a multiple award contract and then bid again for the actual task orders. The average value of a contract action has dropped by nearly 50 percent by virtue of the incremental buying that task orders represent. And competition at all levels has intensified. This has presented challenges for companies of all sizes, but most especially for small and mid-tier firms. At the same time, structured properly, these contracts can offer excellent opportunities for small businesses.

While there is little doubt that improvement is always needed, we are also witnessing an increasing number of very large contracts that are being inappropriately set-aside for small businesses. Take for example, a disaster recovery IDIQ architectural and engineering contract that was valued at $150 million over a five year period and that required the bidding firms to be able to conduct work in just about every state. The work was set-aside for small business. Yet, how many small businesses have that kind of capacity? Would it not have been smarter to either award such a contract to a more suitably sized company and build into the contract significant small business subcontracting goals, or to compete regionally-based awards?

Next, consider that the current size standard for architectural and engineering services is $4.5 million in annual gross receipts. While this set-aside may initially seem like a great opportunity, should a disaster occur and significant task orders need to be issued against that contract, it is likely that firms will struggle with the workload. Furthermore, the contractor's revenues are sure to skyrocket causing it to lose its small business size status, which is not necessarily a bad thing, but because the vast majority of its revenues are coming from performance on one contract the company will either be forced to compete in the "full and open" market to maintain its workforce in the future or will revert back to being a small business. Furthermore, the requirement that small businesses perform at least 51 percent of work awarded under a set-aside with its own workforce will place a significant burden and risk on the contractor to meet the terms of the contract.

Adding fuel to the debate around size standards is the fact that the federal government lacks policies regarding mid-tier contracting—firms that were once eligible to receive small business set-asides, but whose revenues now exceed the size standards. If SBA policy is not only to create federal contracting opportunities for small businesses but also to ensure their long-term success and a sustainable growth pattern, then the plight of small businesses that "graduate" from their industry size standard should not be ignored. Hence, the federal government should explore options that will incentive contracting opportunities for mid-tier businesses. Such incentives do not need to create separate goals for contracting with mid-tier companies, but should provide contracting officers with the flexibility to reserve certain contracting opportunities for mid-tier businesses once they have determined that the opportunities are not suitable for competition exclusively among small businesses.

Lastly, many of the changing dynamics surrounding federal contracting are a result of a federal acquisition workforce that is overburdened and understaffed. Because the federal acquisition workforce has not been provided with the necessary resources to keep pace with the growth of government contracting, they are often forced to find efficiencies that may be to the detriment of small and mid-tier firms. Addressing these workforce gaps can help to alleviate such instances.

SPECIFIC ISSUES WITH PROPOSED RULE

The proposed rule published by SBA on March 16 raises size standards for 36 industries and maintains the status quo for 10 industries. For most industries, the increases to the size standards were fairly substantial. For example, most size standards that have been established at $7 million were increased to either $10 million or $14 million. That increase will provide much-needed flexibility for small firms to mature while still having access to restricted competitions. However, these proposed thresholds have not been elevated to the extent that very small businesses will not also have legitimate opportunities. There are, however, proposals for two areas, architectural and engineering (A/E) and computer related services, that require greater scrutiny.

The proposed size standard for A/E ballooned from its current level of $4.5 million to $19 million, which begs the question of what has changed so dramatically in that industry over the years to warrant a quadrupling of the size standard. In contrast, computer-related services have undergone significant changes over the last 20 years and the federal government is purchasing more of these services than at any time in its history, yet the SBA proposed raising size standards for those categories by only $500,000, from $25 million to $25.5 million.

In addition, SBA established "common size standards" for industries that share similar characteristics. According to SBA, these common size standards reflect cases where many of the same businesses operate in the multiple industries, and might also make size standards among related industries more consistent than establishing separate size standards for each of those industries. This led SBA to establish a common size standard for the Computer Systems Design and Related Services industries (NAICS 541511, NAICS 541112, NAICS 541513, NAICS 541519 and NAICS 811212), even though the industry data supported a distinct size standard for each industry. The common size standard proposed by SBA for these categories was $25.5 million. However, SBA analysis shows that for NAICS 541513—Computer Facilities Management Services—the calculated industry specific size standard is $35.5 million. Therefore, by establishing a common size standard containing this NAICS category and other computer related categories at a level of $25.5 million, SBA has eliminated legitimate small businesses from being able to qualify. This same dynamic can also be applied to the common size standard for architectural and engineering services, where SBA calculated significant differences between each industry specific size standard.

As mentioned above, SBA evaluated five major factors to determine the proposed size standards: average firm size; startup costs and entry barriers; industry competition; distribution of firms by size; and impact on federal contracting and SBA loan programs. SBA determined that each factor would be given equal weight in its calculations. However, PSC recommends that greater weight should be given to the "impact on federal contracting" factor. In addition, SBA should broaden its evaluation of the federal contracting market to examine if typical contract requirements under a specific category tend to gravitate towards larger contracts. If so, SBA might determine that a higher size standard is warranted. If typical requirements under a specific category seem better suited to small contract awards, then perhaps a small size standard would be more appropriate.

PSC further encourages SBA to reconsider the merits of adopting separate size standards for the purposes of federal contracting. The adverse impact on small businesses of a single size standard that covers federal procurement and all other SBA programs is documented in SBA's own methodology. SBA acknowledges that the disparity between small business federal market share and industry-wide share may be attributed to a variety of reasons, such as extensive administrative and compliance requirements associated with federal procurement, the different skill sets required by federal contracts compared to typical commercial contracting work, and the size of specific contracting requirements of federal customers. Such a structure would allow SBA to focus more on the federal market dynamics regarding contracting.

SUMMARY OF RECOMMENDATIONS

PSC recommends a number of steps that can be taken to improve the size standard proposal and more broadly improve small business contracting opportunities across the federal marketplace.

With regard to the size standard proposal, PSC recommends that SBA give more weight to the "impacts on federal contracting" factor and broaden its analysis of specific federal market dynamics that distinguish the federal market from the commercial space. Taking this recommendation further, SBA should consider creating a completely separate set of size standards to be used for federal procurement purposes only.

In addition, SBA should review its policies regarding the creation of common size standards. Under the proposed rule, the use of common size standards will eliminate small businesses from competition whereas, if the individual industry size standard had been adopted, then all small businesses would be able to compete. In certain cases such as architectural services the use of common size standards would result in a number of firms being considered "small" that have annual revenues well-above the calculated value of the individual industry size standard. If SBA is unwilling to uncouple the common size standards, then it should adopt the highest individual industry size standard. We recognize such an approach would mean that some larger firms would become eligible to compete for small business set-asides; however, it would also ensure that no legitimate small businesses would be shut out from competition.

Beyond the current rule making process, SBA and Congress should support new and ongoing initiatives to incentivize contracting opportunities for mid-tier businesses to ensure that growing small business are provided, at minimum, some protections before having to always compete with large businesses. Additionally, Congress should support initiatives to rebuild the federal acquisition workforce and ensure that it has appropriate training opportunities. Such investments will likely decrease instances of contract bundling and result in the creation of contracts that are suitably sized for small business competition. Lastly, Congress should provide the necessary oversight of SBA to make sure that SBA is abiding by the provision enacted in last year's Small Business Jobs Creation Act that requires SBA to review and update the size standards every five years, at minimum.

Mr. Chairman, this concludes my testimony. Again, thank you for inviting PSC to testify today and for your attention to this important issue. I would be happy to answer any questions you may have.